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SUBJECT: KAZAKHSTAN: 2007 INVESTMENT CLIMATE STATEMENT

REF: 06 STATE 178303

1. The following information is provided in response to
reftel request.

Openness to Foreign Investment

Kazakhstan has made significant progress toward creating a market economy since its independence in 1991. The European Union in 2000 and the U.S. Department of Commerce in March 2002 recognized the success of Kazakhstan's reforms by granting it market economy status. Kazakhstan also has attracted significant foreign investment since independence. By July 2006, foreign investors had invested a total of about \$46.2 billion in Kazakhstan, primarily in the oil and gas sector, during the country's fifteen years of independence. Following independence, the government created a favorable regime for oil and gas investments at the same time that it undertook other liberalizing economic measures and began an ambitious privatization program.

Despite continuously increasing investment into Kazakhstan's energy sector, concerns remain about a tendency on the part of the government to challenge contractual rights, to legislate preferences for domestic companies, and to create mechanisms for government intervention in foreign companies' operations, particularly procurement decisions. Together with vague and contradictory legal provisions that are often arbitrarily and inconsistently enforced, these negative tendencies feed an enduring perception that Kazakhstan is becoming less open to investment.

Four major pieces of existing legislation affect foreign investment. These are: 1) the 2003 law "On Investment?; 2) the 1997 law "On Government Procurement?; 3) the 2001 Tax Code; and 4) the 2003 Customs Code. These four laws provide for non-expropriation; currency convertibility; guarantees of stability in the legal regime; transparent government procurement; and incentives in certain priority sectors, including electrical infrastructure, telecommunications, light manufacturing, health and tourism. However, inconsistent implementation of these laws and reforms at all levels of government remains the key obstacle to business in Kazakhstan.

Since 1997, there has been a growing trend to favor domestic investors over foreigners in most state contracts. Furthermore, amendments passed in 1999 to the Oil and Gas Law require mining and oil companies to use

local goods and services. According to these ?local content? regulations, subsurface users in Kazakhstan are obligated to purchase goods and services from Kazakhstan entities -- provided that the local goods meet minimum project standards -- and to give preference to the employment of local personnel. Prospective subsurface users are required to specify in their tenders the anticipated local content of their work, goods, and services. Since 2002, a designated government body must approve all tender documents, participate in tender committees, and approve all tender committee decisions, in order to ensure compliance. The 2005 ?Production Sharing Agreements (PSA)? law, which applies primarily to Kazakhstan?s offshore oil development projects, binds companies to similar local context provisions. Amendments to the Subsurface Law adopted in December 2006 further tighten the government?s application of local content requirements, requiring companies to meet local content benchmarks annually, rather than on average over the lifetime of a project.

These requirements are being challenged in connection with Kazakhstan's forthcoming WTO accession negotiations, as they appear to breach GATT and GATS rules and the Agreement on Trade Related Investment Measures. They also appear to contradict the 1994 U.S.-Kazakhstan Bilateral Investment Treaty, which states in Article II, paragraph 5, that "neither party shall impose performance requirements...which specify that goods be purchased locally..."

In January 2003 President Nazarbayev signed a new law "On Investments" that superseded and consolidated past legislation governing foreign investment. The law establishes a single investment regime for domestic and foreign investors, and provides, inter alia, guarantees of national treatment and non-discrimination for foreign investors. It guarantees the stability of existing contracts, with the qualification that new ones will be subject to amendments in domestic legislation, certain provisions of international treaties, and domestic laws dealing with "national and ecological security, health and ethics."

The 2003 law provides for dispute settlement through negotiation, Kazakhstan's judicial process, and international arbitration. However, the law narrows the definition of investment disputes and lacks clear mechanisms for access to international arbitration. U.S. investors should note that the U.S.-Kazakhstan Bilateral Investment Treaty, as well as the New York Convention, protect U.S. investor access to international arbitration. Additionally, the RK Constitution, as well as the 2003 law "On Investments," specifies that ratified international agreements have precedence over domestic law. The May 2005 Law on International Agreements appears to contradict this legal hierarchy, setting precedence of domestic law of the RK over its international agreements. For the purpose of eliminating this contradiction from the law, the Parliament has recently passed amendments to the Law on International Agreements that re-state the precedence set by the Constitution of ratified international agreements over domestic law. The amendments will become effective once they are signed by President Nazarbayev. Finally, in December 2004 Kazakhstan adopted a law ?On International Commercial Arbitration? (see ?Dispute Settlement? for full discussion).

The 2003 law contains investment incentives and preferences based on government-determined sectoral priorities, and provides for investment tax preferences, customs duties exemption